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INTELLIGENCE HIGHLIGHTS NO. 12
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ARMY Declass/Release Instructions On File

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The preliminary allotment for the rehabilitation of Japan, Korea, and the Ryukyus is one-half of that originally requested by the Department of the Army. However, the sum for Japan is to be supplemented by a 150 million dollar revolving fund (page 3).

The Philippine Government announces a policy of continuing limited trade with Japan, based upon benefits to the Philippines (page 3).

The prohibition of the Kuomintang Party by the Siamese Government may signal the resumption of an extensive anti-Chinese campaign (page 4).

The 31 July Japanese Cabinet ordinance which in accordance with a SCAP "suggestion" prohibits government employees from striking or bargaining collectively, has provided the Japanese Communist Party with a favorable issue for winning popular support of their attack on Occupation policies (page 5).

Agitation in Nationalist-held Manchuria for a regional government independent from Nanking may speed up disintegration in Nationalist China (page 7). Public Chinese criticism of the US aid program, for a variety of reasons, continues to mount (page 7). The pessimistic military, political and financial outlook for the National Government contrasts sharply with the confident tone of current Chinese Communist broadcasts (page 8).

Support for the Burmese Government Party (AFPPFL) has been weakened by further defections (page 10).

NOTE: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) Double asterisk (**) --placed at beginning and end of information based solely on "S/S distribution" series.
- (2) Single asterisk (*) --to flag item containing "S/S distribution" series.
- (3) "A", "B", or "C" --importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

~~SECRET~~~~CONFIDENTIAL~~

SECRET

-2-

SUMMARY (continued)

Reorganization of the Ho Chi Minh Government in Indochina may represent a consolidation of Communist control (page 10).

Recent actions of the Indonesian Republican Government may lead to greater leftist influence (page 10).

The surrender of arms by dissidents will not be stressed by the Philippine Government (page 11).

Section III - Summary of ORE 12-48 "Prospects for a Negotiated Peace in China" (page 12).

CONFIDENTIAL

~~SECRET~~

SECRET

-3-

SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Preliminary rehabilitation estimates for Japan, Korea, and the Ryukyus

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The Department of the Army has formulated preliminary estimates as to the amount of Government and Relief in Occupied Areas (GARIOA) funds that will be available for economic rehabilitation purposes in Japan, South Korea, and the Ryukyus. It has decided to allot within the first 6 months of the fiscal year 1949, \$75,000,000 of the Congressional GARIOA appropriation of \$1,300,000,000 subject to re-examination in two or three months with a view to determining whether additional GARIOA funds can be made available for economic rehabilitation purposes and whether or not it is desirable to request supplementary appropriations at the next session of Congress. The \$75,000,000 is broken down as follows: Japan \$51,400,000; South Korea \$20,200,000; Ryukyus \$2,400,000; (\$1,000,000 is being withheld for a special project). The Department stresses that although its estimates cover only the first six months of the fiscal year 1949, these funds may be the only ones available for the entire fiscal year.

Thus, the allotment for economic rehabilitation is exactly one-half of that originally requested of Congress by the Department of the Army. On the other hand insofar as Japan is concerned, this sum is supplemented by favorable Congressional action on a \$150,000,000 revolving fund.

Philippine-Japanese trade policy announced by President Quirino

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During a 29 July press conference, President Quirino made the first official declaration concerning his Government's policy regarding the hotly disputed Philippine-Japanese trade issue. Quirino said that limited trade with Japan, based upon benefit to the Philippines, would be continued. The president announced that, although the Philippines would adhere to Far Eastern Commission policy of dealing with Japan as a subjugated country under SCAP, the Philippine trade mission in Japan would be raised to a consulate. Quirino also indicated that the Philippine Import Control Board (which at present controls only luxury and non-essential imports) may be used to implement the newly-announced trade policy.

Filipinos have been acutely sensitive about dealing with their former enemies largely because of the widespread feeling that trade relations might contribute to Japanese industrial and military resurgence. For example UN Ambassador Carlos P. Romulo, during a recent trip to the Philippines, publicly declared that reparations and indemnification for victims of Japanese aggression should be prior considerations to the resumption of any relations with Japan. Romulo also maintained that the "regeneration" of Japan will

SECRET

SECRET

-4-

General (continued)

begin only after a peace treaty is signed and that the Philippines should "go very slowly" in resuming trade relations.

Although Quirino's policy statement clarifies the Government's position, it can be expected that the principle of Philippine-Japanese trade will be the subject of a continuing and often bitter public controversy in the Philippines.

Prohibition of KMT announced by Siamese Government

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The chronic Chinese problem in Siam has recently been intensified by a governmental announcement of the prohibition of the Kuomintang (KMT) as an illegal, unregistered and alien political party. A responsible government official stated further that the KMT would not be registered even upon application. To date, the brunt of Siamese antagonism and increasing anti-Chinese sentiment has been directed at the local Chinese Communists. The banning of the KMT, in view of the inability of Chinese Nationalist Government and local Chinese to make effective representations at present, may signal the resumption of an extensive anti-Chinese campaign marked by arrests and deportations directed at all Chinese elements in Siam.

SECRET

SECRET

-5-

JAPAN

The 31 July Japanese cabinet ordinance which, in accordance with a SCAP "suggestion", prohibits government employees from striking or bargaining collectively has provided the Japanese Communist Party (JCP) with a favorable issue for winning popular support for an attack on occupation policies. Openly challenging the legality of the order, Communist-dominated unions have demanded the resignation of the ASHIDA Cabinet and the dissolution of the Diet. The new labor restrictions have assisted Communist promotion of a common labor front by forcing more moderate leadership to choose between a pro or anti-government stand. "A"

SCAP's action embarrasses the Socialists who, because of their participation in the Ashida coalition cabinet, must share responsibility for implementing the measure in the face of wide-spread labor disapproval. Socialists leaders have claimed that they can protect labor's interests better by remaining in the government than by permitting the conservative domination of the government which would result from Socialist withdrawal. Doubt as to the ability of the Socialists to maintain this claim has been reflected in losses to the party in Diet membership and in set-backs suffered by the Socialist-sponsored anti-Communist movement in labor.

In the present crisis the government has stated that it is carrying out the wishes of occupation authority but the question arises whether the Socialists can continue to associate themselves with actions so injurious of party fortunes. Although the cabinet's ordinance contains a sop to its Socialist members in providing for government employees' grievance machinery such a limited gain will hardly halt falling Socialist prestige.

Communist threats leave open to question whether the unions will obey the cabinet ordinance. The JCP may elect to provoke the Occupation into physical suppression of Japanese labor, thereby acquiring the cloak of martyrdom. In the event of the Occupation's suppression of communist inspired violence, however, there is a chance that Japanese respect for authority would cause the JCP to lose prestige and permit some Socialist recovery of the initiative in the labor movement.

KOREA

Lee Bum Suk compromise choice for South Korean Premier. The final choice of General Lee Bum Suk as premier represents a compromise between Rhee and the political parties. In originally nominating the North Korean Lee Yun Yung, who has no political following, Rhee Syngman apparently had hoped to cut across party lines to secure the election of a premier "B"

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SECRET

-6-

KOREA (Cont.)

who would be a mere figurehead and at the same time lend an "all-Korean" character to his government. The defeat of Lee Yun Yung, however, is evidence that Rhee's previous success in securing the adoption of a constitution which met his demands appears to have made him over-confident of his personal prestige in the National Assembly and of the degree to which he had broken down party loyalties. The politically-cautious General Lee, although nominally a member of Rhee's machine, is actually in a somewhat intermediary position having never really committed himself to any one party or bloc. Thus, support for his election cut across party lines to Rhee's advantage while at the same time party leaders forced Rhee to give up his attempt to secure a political non-entity for the post.

SECRET

SECRET

-7-

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Agitation in Mukden for a Manchurian regional government independent of Nanking, is further evidence of political disintegration in Nationalist China. From the purely military standpoint, the city appears to be fairly secure at present, but economically its plight is worse than that of any other major Nationalist city. Manchurian grievances have accumulated over the past two years because of corruption and maladministration under Nationalist officials imposed by Nanking. The current unrest in Nationalist-held Manchuria, touched off by the killing of several Manchurian students during the suppression of civil disturbances which occurred several weeks ago in Peiping, is abetted by the belief of native Manchurian leaders that the military power of Chiang Kai-shek is rapidly crumbling. This discontent might crystallize in the latter part of this month into a move to establish an "emancipated regional government". In such an event, the local Nationalist troops under Wei Li-huang probably would refrain from attempting to quell the movement by force, since street fighting on a large scale might enable the Chinese Communists to seize the city.

"A"

The Nanking Government, which hitherto has done little to answer Manchurian complaints, is now attempting belated measures of pacification. An open break between Mukden and Nanking might prompt like action elsewhere, especially in North China where there are strong similar tendencies. Such regional regimes presumably would be anti-Communist, although they would probably be inclined to seek an end to actual fighting through negotiation. (See ORE 12-48 "Prospects for a Negotiated Peace in China", 3 August 1948.) In contrast to the dismemberment threatening the National Government, the Chinese Communists confidently assert that they will soon consolidate their four liberated areas north of the Yellow River, and that their military forces are now strong enough to overwhelm any Nationalist fortified city.

Chinese public criticism of the US aid program continues to mount, despite the National Government's insistence on the necessity for additional aid. Although an overwhelming majority of the Chinese masses are either ignorant of the aid program or apathetic to it, many articulate Chinese feel that present US aid will accomplish little of a beneficial nature, and will merely prolong the civil war and postpone the fall of the present unpopular National Government. Among the merchants and businessmen, except those affiliated with government-controlled economic agencies, resentment stems from the belief that the aid program will be handled not by private traders but by the Government to the profit of the "Four Families" who have a virtual monopoly control over Chinese economic life. The Chinese laboring class, although unaware of the complex aspects of the aid program, is affected directly by the devastating inflation and therefore is particularly receptive to Communist charges that the US aid program with its allegedly

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SECRET

SECRET

-8-

secret commitments, is further evidence of US imperialism. From North China come charges that the National Government considers that area lost territory and so is discriminating in the distribution of US aid in favor of South China. Further hostility to the aid program may be expected through its identification with the rebuilding of Japan, particularly if the proposed US plan to promote Sino-Japanese trade materializes. Nevertheless, the Chinese Government continues to press the US for further immediate aid, while anticipating that a Republican victory in the US November elections will facilitate the granting of even greater help to Nanking.

Recent pronouncements by the Chinese Communist radio, although predicting that there still remained "three or four years of bitter struggle" before the "liberation" of all China, have expressed complete confidence in the Communists' ability to reach that goal. The broadcasts emphasize the great strides taken by the Communist forces in the past two years and predict that, under the "correct" guidance of Mao Tse-tung, further strides will be made deep into Kuomintang territory. The Communist Army, it is pointed out, has captured thousands of US-supplied Nationalist artillery pieces and are now capable of overwhelming any Nationalist fortified city. The Communists claim that almost one-fourth of China's area and over one-third of its people are now under their sway and promise that the day when the four liberated areas north of the Yellow River -- now separated by Nationalist holdings along the Peiping-Suiyuan and Peiping-Chinhai railways and by a half dozen or so isolated Nationalist cities -- would be joined is "not far off". In addition the Communists, who are planning to convoke a People's Consultative Conference under their own aegis this year, declare that they will not be hoodwinked by any "fake peace" achieved through the efforts of a bogus "anti-Chiang, anti-civil war, anti-dictatorship camouflage" erected at the instigation of the US, but will insist on the complete overthrow of the reactionary Kuomintang and the ouster of US imperialism from China. "B"

The Chinese Communist radio at times provides candid insights into Communist aims and what the Communists consider their own capabilities and limitations.

The production and supply to the US of strategic materials for stockpiling purposes is to be governed according to the US interpretation of the China Aid agreement. An exchange of aides-memoire between the Nanking Embassy and the Chinese Foreign Office confirms this understanding. "C"

Establishment of a Joint Rural Reconstruction Commission is provided in an exchange of notes between the US Embassy, Nanking and the Chinese Foreign Office suggested for signature 5 August. "C"

SECRET

SECRET

-9-

Possible Economic Crisis in August. There are growing indications of "C" an "imminent" financial crisis within Nationalist China, possibly in August, according to the US Military and Naval Attaches Nanking. The following are cited as basic causes for such an eventuality: (1) exhaustion of foreign exchange funds, (2) sharp decline in national revenue, and (3) deterioration of vital industries, utilities and communications, due to financial difficulties. In the opinion of the Economic Counselor, US Embassy Nanking, inflation is in its "final stages" with prices rapidly becoming meaningless; also Embassy sources have verified the critical nature of the Central Bank's foreign exchange position and the claims of the Bank that it is unable to repay loans now due the Export-Import Bank, Bank of China, and meet other commitments.

Currency/Prices. Shanghai prices changed relatively little during the "C" past week, although market conditions remained fundamentally chaotic. Extreme shortage of currency was responsible for temporarily retarding a renewed run-a-way price wave which is expected to develop in a matter of days. The CN \$ blackmarket interest rates of from 60 to 90 percent per month drew currency from commodity markets into money markets. The US dollar began to climb on the blackmarket over the week-end, reaching a high of CN \$9 million to 1, on 2 August. In spite of the announcement that "bedrock" economic reforms will be instituted this week no far-reaching improvement is seen for the immediate future.

The Shanghai Market:		<u>US \$ Exchange (Selling Rate)</u>		<u>Wholesale Price of Rice "C"</u>
		<u>official "open"</u>	<u>Blackmarket</u>	<u>per 172 lb picul</u>
This week	(29 Jul 48)	CN \$480,000	CN \$6,800,000	CN \$36,000,000
Week ago	(22 Jul 48)	480,000	7,500,000	42,000,000
Month ago	(29 Jun 48)	480,000	3,850,000	18,500,000
Year ago	(29 Jul 47)	12,000	42,000	400,000

Yangtze Floods. Flood waters from the Yangtze River continue to spread "C" out in vast areas of the middle and upper regions, causing heavy tolls in life and property. It is estimated thousands are dead and millions homeless. Resulting crop losses threaten the effected areas with widespread starvation. Although waters have receded slightly in the lower river sections the flood peak is not yet in sight.

SECRET

SECRET

-10-

INDONESIA

Actions of Republican Government may complicate work of GOC. Two recent actions by the Indonesian Republican Government indicate greater distrust of the motives of the Dutch and pro-Dutch factions. "B"

On 28 July the Republican Government endorsed a "National Program" which had been drafted by major political organizations including the leftist People's Democratic Front. The Republican Government announced officially on 31 July that it could not support the resolution drafted and approved at the Bandoeng Conference attended by the heads of non-Republican regimes. The Republic argued that the resolution allowed the Dutch to retain all of their former authority during the period prior to the establishment of a United States of Indonesia. Failure of the Republic to consider this plan may widen the breach between Republican and non-Republican Indonesians since the latter group had counted heavily on Republican support in forcing the Dutch to make more liberal concessions to Indonesian rulers.

As an immediate result of these actions, leftist groups, which have been excluded from the present moderate government, may be expected to exert a greater influence in Republican areas. Such a development will further complicate the work of the UN Good Offices Committee.

BURMA

Dissident PVO faction goes underground. The Burmese Government has recently taken action against a faction of the Peoples' Volunteer Organization (PVO) which refused to accept Prime Minister Thakin Nu's Leftist Unity Plan by closing the PVO headquarters and arresting several of its members. Other members are reported going underground with their weapons and raiding villages in order to secure additional arms. It is probable that they will join the Communists in their insurrection against the Government. This development marks a further decrease in the overall support of the Anti-Fascist Peoples' Freedom League (AFPFL), the Government party. Furthermore, serious repercussions may be felt in the army and police force because at least 30% of their personnel are drawn from the PVO. "B"

FRENCH INDOCHINA

Ho Chi Minh Government reorganized. A recent reorganization within the Ho Chi Minh Vietnam Government may represent a further consolidation of communist control. At a cabinet meeting held early in July, a six-member Supreme Council of National Defense was formed. Three members of this Council, including its president Ho Chi Minh, are known communists. Commander-in-Chief Giap, who is one of the communist members, was also named to the post of "B"

SECRET

SECRET

-11-

FRENCH INDOCHINA (continued)

Minister of National Defense, a position which he held for several months prior to the July 1947 cabinet re-shuffle. This reorganization, in which the Supreme Council may, in effect, replace the old government, could be interpreted as a sign of weakness. However, it is more likely that it prepares the way for increased militant action against the French.

PHILIPPINES

Government adopts attitude of unconcern toward arms registration. At "B" a press conference on 29 July, at which he announced the extension of the Hukbalahap arms registration deadline to 15 August, President Quirino declared that he is far more concerned with the implementation of a social amelioration program than he is about the surrender of arms.

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expressed his optimism as to the eventual outcome of amnesty and stated that the Government will pursue a very lenient policy toward the former dissidents. According to him, the Philippine Government will not stress arms registration but instead plans to implement its social and agrarian reform program on the premise that most of the Huks are ignorant peasants with a just complaint against the government and that once assured of fair treatment they will never return to outlawry. warned, however, that the peasants will move cautiously and that there will be some who will refuse to cooperate. The Government is not concerned about Huk arms since it reasons, according to that following the registration deadline, all illegally possessed weapons will have to be concealed probably in places where they will deteriorate rapidly.

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-12-

SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

Prospects for a Negotiated Peace in China

The prospects for a negotiated peace in the near future between the Chinese National Government under its present leadership and the Chinese Communists appear remote. This does not preclude, however, an early cessation of hostilities in some of the presently active military theaters as a result of regional arrangements between opposing commanders. "A"

War-weariness and defeatism are widespread throughout Nationalist China, and although these sentiments have not yet been crystallized into a strong political force, no Nationalist leader can afford to ignore them. So long as Chiang Kai-shek remains in office, however, compromise between the National Government and the Communists appears virtually impossible, Chiang being opposed to negotiations with the Communists and they with him.

Chiang's position is steadily deteriorating and his Government is in such a precarious situation that its collapse or overthrow could occur at any time. His ultimate fall is apparently inevitable, but the prospects of any single leader succeeding to a position with power comparable to that which Chiang now holds are remote. Any successor to Chiang, in order to secure peace, would have to be willing to negotiate on the terms the Communists would demand, and would have to possess the leadership and military support to hold the central government together while promoting such a policy. At the present time, no such leader has appeared. Assuming that Chiang will not be replaced by any effective successor, and assuming further deterioration of the National Government's position, the probability is that before any peace negotiations can be undertaken, the Government will split into regional factions which will be forced to capitulate separately to the Communists.

While the bulk of the people in Nationalist China feel that continued resistance against the Communists is hopeless and therefore pointless, to Chiang and his immediate followers, the fortunes of the Government may appear in a different light. It may be a matter of years before the Communists can achieve total military victory, and before that time comes, Chiang probably feels that he can count on the incentive of presently guaranteed US aid, possible increased aid that might come from a new US administration, and an "inevitable" US-Soviet war in which the US would become his active ally.

The Soviet Ambassador has already made some overtures concerning a peace settlement to certain National Government officials. Given an opportune moment, the USSR would undoubtedly extend its good offices and attempt to exploit the dual advantages of a peacefully communized China, and the propaganda value accruing from apparent advocacy of world peace.

A negotiated peace would have real advantages for the Communists. But since they hold the military initiative and feel sure of final victory, they would probably insist on terms that would ensure their ultimate control of China.

Prospects for a Negotiated Peace in China

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